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In the Supreme Court of the United States

UNISYS CORPORATION,

Petitioner,

v.

COMMONWEALTH OF PENNSYLVANIA, BOARD OF FINANCE AND REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of Pennsylvania

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Respondent's Brief in Opposition reinforces the need for guidance from this Court on the essential question raised by petitioner: whether a clear mismatch between the constituent elements of a tax base and the constituent elements of an apportionment formula is a fatal structural defect in a state taxing scheme. Indeed, respondent does not dispute the fundamental predicate underlying petitioner's case, namely that Pennsylvania's apportionment regime is structurally flawed. Instead, Respondent's Brief in Opposition simply echoes the opinion of the razor-thin majority below that *even in the face of a theoretically flawed apportionment formula,* a taxpayer must demonstrate "gross distortion" in order to prevail on a constitutional claim. Br. Opp. 7.

Respondent's position simply assumes the answer to the question raised by the Petition, and it does so ignoring this

Court's declaration that "[a]ny formula used must bear a rational relationship, both *on its face* and in its application, to property values connected with the taxing State." *Norfolk & Western Ry v. State Tax Commission,* 390 U.S. 317, 325 (1968) (emphasis added). See also *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 169 (1983): "[T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." As Justice Stevens observed in his dissent in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), "[u]nless the sales, payroll and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause [the taxpayer's] . . . income to be overstated." 445 U.S. at 461 (footnote omitted).

I. QUESTIONS OF FACTUAL DISTORTION AND BURDEN OF PROOF ARE IRRELEVANT

Respondent, like the majority below, takes the position that an apportionment formula violates the Constitution only if the taxpayer can demonstrate that the application of the formula produces a grossly distorted result. Br. Opp. 6-8. The position is premised on cases decided by this Court that evaluated constitutional attacks by reference to whether *the application* of an apportionment formula *on the particular facts of the case* resulted in gross distortion[1]. In those cases, there was no mismatch, as there admittedly is here, between a consolidated tax base reflecting the value of many corporations and the use of the factors of just one of those corporations to apportion the consolidated base. Where, as here, the challenged taxing scheme is asymmetrical and the taxpayer is chal-

[1] The cases are discussed at Pet. 15-16.

lenging the constitutionality of the taxing scheme on its face, the level of distortion is simply beside the point. Whenever there is a dramatic mismatch between the components of the tax base and the components of the apportionment formula, the facial rationality test of *Norfolk & Western* is violated, and the taxing scheme is unconstitutional as a matter of law.

Contrary to respondent's claim, and to the majority's holding below, a taxpayer has no burden of factual proof with respect to the facial validity of the apportionment formula. Its only burden is to prevail on its legal argument, because the inquiry is purely legal. Once that burden is met, as petitioner believes it was here, nothing further is needed. As Justice Nigro stated below in his dissent: "[The] complete absence of the subsidiaries from the apportionment formula makes it facially apparent that the Pennsylvania statute reaches beyond constitutional limits and taxes value outside its borders. . . . I simply cannot agree with this shifting of the burden onto Unisys to formulate a constitutionally valid system of taxation to compare with the Department's facially unconstitutional system." App. 47a. Two other dissenting Justices agreed. App. 54a-55a.

II. RESPONDENT'S CLAIM THAT THERE IS NO STATE COURT CONFLICT IS INCORRECT

Contrary to respondent's assertion, the state courts are divided on the question whether a structural mismatch between the tax base and the apportionment formula constitutes a constitutional violation independent of "gross distortion."

Respondent discusses *E.I. Du Pont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82 (Me. 1996), which upheld an apportionment formula that was revised after the Maine Supreme Court's earlier decision in *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991). In *Du Pont*, the revised formula contained an overriding limitation on the in-

come tax that could be imposed on a unitary group, based on a calculation of taxable income that used worldwide combined reporting with full factor representation for all members of the group. Thus, the limitation was symmetrical.

Respondent does not discuss *Tambrands*, where the Maine Supreme Court invalidated Maine's structurally infirm apportionment formula on its face because, although the tax base included dividend income from foreign affiliates, the apportionment formula included no part of the property, payroll and sales of the foreign affiliates. 595 A.2d at 1044. The apportionment formula was unconstitutional on its face notwithstanding that only a 14.9% distortion had been demonstrated.

In *American Telephone & Telegraph Co. v. Wisconsin Department of Revenue*, 422 N.W. 2d 629 (Wis. Ct. App. 1988), *review denied*, 428 N.W. 2d 554 (Wis. 1998), the Wisconsin Court of Appeals likewise found a state's apportionment formula unconstitutional on its face because it was structurally flawed. The court framed the issue as follows:

> The question which this case presents is what are the constitutionally sufficient elements of a formula which apportions to the taxing state intangible income paid by its subsidiaries to a taxpayer engaged in a unitary business. This question has not been dealt with authoritatively by the courts.

422 N.W.2d at 635. The Wisconsin court concluded that the apportionment formula "*does not bear a reasonable relation to the corporate activities of the Bell System in Wisconsin*; it apportions to Wisconsin far too much income of the Bell System in relation to its property located here, its sales here or its payroll." 422 N.W.2d at 636 (emphasis added). The "far too much income" statement presumably reflected the fact that the asymmetrical taxing scheme produced an excessive

apportionment in favor of Wisconsin. But the test that was applied was a structural test.[2]

In short, some courts believe an asymmetrical taxing scheme is invalid on its face because it necessarily fails the rational relationship test. Other courts will strike down an asymmetrical scheme only if it produces a grossly distorted result.[3] In the instant case, the majority believed the proper test was gross distortion; the minority believed the asymmetrical scheme was inherently flawed. Conflict and confusion clearly exist. Only this Court can settle the question.

III. RESPONDENT'S DEFENSES HAVE NO MERIT

None of the defenses offered by respondent cures the facial invalidity of Pennsylvania's apportionment formula. The so-called 25% "reduction"[4] fails to cure it. What respondent labels as a "reduction" is merely a step in the calculation of the tax base. It is not limited to taxpayers that apportion and it has no effect on the apportionment formula. Even after the reduction, the tax base still includes 75% of consolidated net worth and the apportionment formula still includes only the parent company's factors.

The option to elect single-factor (rather than three-factor) apportionment is no help because, as the Commonwealth Court below stated, the single-factor formula also produces unconstitutional results. Thus, the Commonwealth Court below correctly concluded: "We agree with Unisys that the

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[2] The Maine and Wisconsin holdings are consistent with the prescient observation of then Judge Cardozo that an inconsistency between the tax base and apportionment fraction violates federal constitutional principles. *People v. Knapp*, 129 N.E. 202, 206 (N.Y. 1920), *rehearing denied*, 132 N.E. 870 (1921), *cert. denied*, 256 U.S. 702 (1921).

[3] See the cases discussed at Pet. 15-16.

[4] The statutory formula to compute the tax base includes 75% of book net worth; hence, the Commonwealth's label of a 25% "reduction." 72 P.S. § 7601 "Capital stock value".

right to choose between two infirm formulas would not cure the deficiency in either." App. 137a, n.5[5]

The availability of statutory "equitable relief" under 72 P.S. § 7401(3)(2)(a)(18) was made irrelevant by the Pennsylvania Supreme Court's holding below that the Subsection (18) analysis is identical to the constitutional analysis. App. at 28a-29a. In other words, in Pennsylvania, statutory relief is available only if constitutional relief is available.

IV. THERE IS A COMPELLING NEED FOR THIS COURT'S GUIDANCE ON THE "FACTOR REPRESENTATION" ISSUE

Wholly apart from the clear conflict among the state courts, there is a compelling need for further guidance from this Court on the mismatch, or "factor representation" issue. Even the majority below acknowledged it was to some extent flying blind in its analysis:

> It is noteworthy, however, that the United States Supreme Court has not fully developed the contours of permissible apportionment as concerns multi-jurisdictional, affiliated corporations. Moreover, the Supreme Court's overall treatment of the guiding principles has been described as lacking concreteness by commentators as well as by the Court itself. Of particular relevance here, the Supreme Court has expressly left open questions concerning the necessity of factor representation in

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[5] In any event, the existence of another, constitutional option should not preclude a taxpayer from relief from the unconstitutional aspects of the option actually exercised. *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71, 78 (1992) ("we do not think that a State can force a taxpayer to conduct its foreign business through a domestic subsidiary in order to avoid discriminatory taxation of foreign commerce.") See also *Conoco, Inc. v. Taxation & Revenue Department*, 931 P.2d 730, 738 (N.M. 1997), *cert. denied*, 521 U.S. 1112 (1997).

apportionment. *See Mobil Oil*, 445 U.S. at 441, n. 15.

App. at 18a-19a.

In arguing that review of the instant case would not have broad implications, the respondent stands alone. The Tax Executives Institute, representing more than 2,800 of the leading corporations in the United States, Canada and Europe, believes otherwise. So do both the Council on State Taxation, representing 540 multi-state corporations involved in interstate and international commerce, and the Pennsylvania Chamber of Business and Industry, with 10,000 members.

In addition, as noted, while following the gross distortion approach, the majority below candidly expressed its concern regarding the uncertainty in this area: "[T]he Supreme Court's overall treatment of the guiding principles has been described as lacking concreteness by commentators as well as by the Court itself." App. at 19a. That is about as clear a request for guidance as one respectful court could make to another.

This case presents a fundamental constitutional question regarding the facial invalidity of a taxing scheme with consolidated elements in the tax base but only parent company factors in the apportionment formula. The Pennsylvania Supreme Court divided 4 to 3 on the issue. Other state courts have taken similarly divergent approaches in similar contexts. This Court should take the opportunity to stem the continuing flow of litigation on this question by granting review and providing the guidance so badly needed.

CONCLUSION

For the foregoing reasons, this Court should issue the Writ of Certiorari.

Respectfully Submitted,
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